The State of Venture Capital in Western Canada 2016
EXECUTIVE SUMMARY

The venture capital (VC) market in Western Canada has for decades lagged behind Ontario and Quebec, where most Canadian VC activity is concentrated. Over the past two years, due to the economic slump brought on by low oil prices, Western Canada’s share of VC market activity has fallen to its lowest point since 2003. Alberta, in particular, has seen investment fall dramatically, while the Vancouver technology sector remains a bright spot, accounting for the majority of VC in Western Canada.

VC is a key component of the capital financing ecosystem for innovative and growing firms. VC refers to a particular type of private equity that invests in small, highly innovative, high-risk companies. In addition to providing financing, they possess business management experience, marketing expertise, intimate industry knowledge, and strong professional networks that contribute to a firm’s success. They tend to focus on a particular sector and stage of business development, and make multiple investments, or deals. VC is a crucial part of the process by which entrepreneurs and businesses turn innovative ideas into marketable, commercialized products, services or processes.

The Canadian VC market is large by international standards. In 2015, VC investment in Canada was, in absolute terms, second-highest out of the G7 countries, trailing only the US. As a share of the economy, measured by Gross Domestic Product (GDP), Canada’s VC market also ranks second in the G7. By either measure it lags the US by a substantial margin. VC investment totaled $3.1 billion in Canada in 2016, compared to $89.3 billion in the US.

Western Canada has a small VC market compared to the central provinces, attracting $609 million of VC investment in 2016, compared to $1.4 billion in Ontario and $1.1 billion in Quebec. British Columbia, with $420 million, accounted for over two-thirds of the West’s VC market. 2016 was the worst year in decades for Alberta; VC investment fell to a mere $24 million, a loss of 90 percent from 2014. VC investment in Manitoba reached $147 million, making 2016 the province’s best year since 1996. Investment in Saskatchewan was a more modest $17 million. Manitoba and Saskatchewan have traditionally had relatively low VC activity and are historically more susceptible to large fluctuations.

There were 80 companies in Western Canada which attracted VC financing in 2016, receiving an average of $7.6 million each. Average deal sizes have grown in recent years, but are still smaller than in Ontario, and dwarfed by the United States. At the same time, late-stage deals, which tend to be the largest, accounted for 86 percent of VC activity in Western Canada in 2016, more than in Quebec, Ontario or the United States.

Early-stage investment in Alberta has slowed dramatically over the last two years: from $45 million in 2014, to $6.9 million in 2015, and only $2.4 million in 2016—making 2016 the worst year ever to be an early-stage company seeking VC investment in Alberta. The situation is even more pronounced in Manitoba and Saskatchewan. Thomson Reuters records no VC investment in early-stage companies in Manitoba since 2009, and almost none in Saskatchewan ($4.7 million, less than four percent of the total).

Firms based in the information and communication technologies sector attracted over 51 percent of VC investments in Western Canada in 2016. The life sciences sector, which includes industries like pharmaceuticals, medical devices, biotechnology, and genomics, attracted 41 percent of VC investment in Western Canada, its biggest share in the last twenty years. By contrast, in the rest of Canada, life sciences made up only 15 percent of investment. Four of the five largest Canadian VC deals in 2016 went to life sciences companies.

The analysis in this report is based on data obtained from the Thomson Reuters VC database, which is current as of December 2016.

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2 US National Venture Capital Association, in Canadian dollars.
VC Activity in Western Canada, 2016

- **BC**: $420M invested in 56 companies accounting for 69% of VC investments in Western Canada
- **AB**: $24M invested in 13 companies accounting for 4% of VC investments in Western Canada
- **SK**: $17M invested in 5 companies accounting for 3% of VC investments in Western Canada
- **MB**: $147M invested in 6 companies accounting for 24% of VC investments in Western Canada
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**INTRODUCTION**

Venture capital (VC) refers to a particular type of private equity investment that targets small, highly innovative, high-risk companies that generally have difficulty securing traditional equity and debt financing. VC investors tend to focus on a particular sector and stage of business development where they gain specific knowledge, experience and expertise. VCs have two distinct advantages in the capital financing market: (1) they have expertise and are well positioned to identify companies and innovations with high potential, and (2) they have management experience, business knowledge, industry connections and marketing acumen that increase the probability of a successful outcome. VC investment can occur at any stage of a company’s development and usually happens over several deals (e.g., follow on investment, meeting performance benchmarks). For example, a start-up company might receive a small amount of “seed” funding—as little as $50,000—from an “angel” investor, someone who specializes in start-ups. As the company expands, it would receive further, progressively larger, rounds of funding, from the original investor or from a (group of) VC fund(s). A typical VC investment in an early-stage company might be from $1 to $5 million, while later-stage companies can receive $50 million or more in a single deal. When investment in a company or project has run its course, resulting in either success or failure, its VC investors cash-out or “exit” their investments, and channel the proceeds into another company.

VC is a crucial part of the process by which entrepreneurs and businesses turn their innovative ideas into fully-fledged marketable, commercialized products, services or processes. A well-functioning VC market is a critical component of a thriving environment for innovation.

**CANADA AND THE WORLD**

The size of the Canadian VC market compares well internationally. In 2015, VC investment in Canada was, in absolute terms, second-highest out of the G7 countries, trailing only the US.³ As a share of the economy, measured by Gross Domestic Product (GDP), Canada’s VC market also ranks second in the G7 (Chart 1). By either measure it lags the US by a substantial margin. There are multiple interrelated explanations offered for why Europe’s VC markets are relatively smaller than those in the US, including: lower returns to VC, weak Initial Public Offering (IPO) markets, the greater importance of conservative bank capital, a lack of highly qualified personnel and entrepreneurs, poor practices by VC fund managers, and a societal aversion to risk.⁴

It has been suggested that Canada has historically had difficulties in the development of new and innovative businesses, in part due to a lack of sufficient VC to fund the commercialization of new ideas.⁵ Recently, VC investment has improved significantly, but one sign of Canada’s continued weakness in innovation is that its business expenditure on research and development (BERD) is the second-lowest in the G7 as a share of GDP.

**CHART 1: VC INVESTMENTS AS A PERCENTAGE OF GDP (2015)**

*2014 data

Source: OECD

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³The Conference Board of Canada
Western Canada’s Share of Domestic VC

Between 1996 and 2016, VC investment in Canada more than tripled from $889 million to $3.1 billion. VC investment in 2016 was 15 percent greater than it was in 2015. VC activity in Western Canada accounted for 19 percent of Canadian VC and was 16 percent higher than in 2015, but still lagged the exceptional performance of 2014. In Quebec, VC activity increased 22 percent to $1.1 billion in 2016, the province’s best year since 2000 and nearly doubled from two years ago. Ontario saw a relatively modest 10 percent increase in 2016, to a total of $1.4 billion, and its best year since 2002.

Canada has experienced two recessions (the Great Recession and the oil and gas recession) and one significant economic slowdown (the dot-com bubble bursting) since 1996 (indicated by grey boxes in Chart 2, page 4). These tend to coincide with markedly decreased VC activity. The most recent recession, in 2015, was largely driven by falling oil and gas prices and primarily affected Western Canada, Alberta and Saskatchewan in particular, and Newfoundland and Labrador.

Over the past two years, Western Canada’s share of VC market activity has fallen to its lowest point since 2003. In 2016, British Columbia accounted for 13 percent of the national total, down from 22 percent in 2014, while Alberta accounted for a mere 1 percent, down from 9 percent in 2014. Quebec’s share in 2016 ticked up to 34 percent, while Ontario’s slipped to 44 percent. Manitoba accounted for 5 percent of Canadian VC activity, the most since 1997.

VC as a Share of GDP

Calculating VC as a share of economic activity (measured by GDP) shows the intensity of VC investment, that is, the size of a region’s VC market relative to its overall economy. British Columbia outperforms most other provinces by this measure (Chart 3, page 4)—in 2015, the latest year for which GDP data is available, VC activity in British Columbia amounted to 0.18 percent of its GDP, compared to 0.27 percent in Quebec, 0.21 percent in Ontario, and 0.07 percent in Alberta. Saskatchewan and Manitoba lagged substantially in this measure at 0.01 percent each.

In order to obtain a long-term view that is less susceptible to year-to-year volatility, a ten-year average (2006-2015) of VC share of GDP is examined (Chart 4, page 4). Western Canada (0.11 percent) as a whole underperforms the rest of Canada (0.15 percent). British Columbia (0.17 percent) is the only Western province to score higher than the national average; VC accounted for only 0.07 percent of Alberta’s GDP, 0.06 percent of Saskatchewan’s, and 0.05 percent of Manitoba’s.
CHART 2: VC INVESTMENT IN CANADA, BY REGION ($B)

Source: Thomson Reuters

CHART 3: VC INVESTMENT AS A PERCENTAGE OF GDP, 2015 (%)

Source: Thomson Reuters, Statistics Canada

CHART 4: VC INVESTMENT AS A PERCENTAGE OF GDP FOR WESTERN PROVINCES, 10-YEAR AVERAGE (%)

Source: Thomson Reuters, Statistics Canada
WESTERN CANADA
**VC INVESTMENT**

VC investments totaled $609 million in Western Canada in 2016, up from $525 million in 2015, but still less than in 2014 (Chart 5). The recent oil and gas recession contributed to the reduction in VC investment over the past two years. The decline followed an exceptionally good year in 2014, which saw the highest level of investment in the West since 2000. Still, in 2016, VC investments more than doubled the low reached in 2009, during the Great Recession. Adjusting VC investments for inflation yields similar results to the nominal analysis; it is clear that recent VC investment is still well below the peak in the early 2000s. Additional analysis using a smoothed three-year moving average to reduce year-to-year volatility confirms this trend of improving performance of VC investment and reveals that in 2015 it reached its highest level since 2002.

Investment rose in three of the four western provinces in 2016 (Chart 6). The steepest increases in relative terms occurred in Manitoba and Saskatchewan, where investment rose an impressive 3,584 percent and 490 percent to $147 million and $17 million, respectively. Manitoba experienced the best year of VC investment in its history, rebounding from a record low in 2015, and actually outpacing the much larger economy of Alberta for the first time ever. Most of the gain was due to a handful of large investments in the information technology and life sciences sectors. It should be noted that large VC investments such as these are highly volatile from year to year, as are investments in Manitoba and Saskatchewan in general.

VC investment in British Columbia rose 10 percent from 2015, to $420 million. In Alberta, investment fell by 82 percent to only $24 million, its worst year since 1996.

Using a 3-year moving average, VC investment has been steadily rising in British Columbia since 2011 while falling in Saskatchewan and Alberta. British Columbia received 69 percent of all Western Canada’s VC investment in 2015, its largest share since 2006. Taken together, these figures suggest a steady trend towards the concentration of Western Canadian VC investment in British Columbia and the growing prominence of British Columbia’s VC market within Canada.

**CHART 5: VC INVESTMENT IN WESTERN CANADA ($B)**

Source: Thomson Reuters, Statistics Canada

**CHART 6: VC INVESTMENT IN WESTERN CANADA, BY PROVINCE ($M)**

Source: Thomson Reuters
**Number of VC Deals**

Each investment by a VC firm in a company is recorded as a separate deal. For example, if three VC firms contributed funding to a single round of investment in a company, this investment scenario would be recorded as three separate deals. 94 VC deals were completed in Western Canada in 2016, consistent with the average number of deals over the past decade (102), but far below the peak of 254 deals conducted in 2000 (Chart 7). The majority of western Canadian deals in 2016 were located in British Columbia (72 percent), the highest proportion seen during the last 20 years. There was a steep decline (33 percent) in the number of deals conducted in Alberta, but not as steep as the reduction in the amount invested.

The average size of these deals has been rising for several years—in Western Canada it has risen steadily from $3.6 million in 2010 to $6.5 million in 2016. Average deal sizes are approximately the same as in the rest of Canada. In 2016, Alberta’s average deal size fell precipitously while Manitoba’s rose sharply. Economic theory suggests that larger VC deals are associated with higher success rates. It is a generally-accepted principle of VC market policy that no company or project should be held back by a lack of available funds; their success or failure should be determined by the merits of their business ideas.

![Chart 7: Number of VC Deals in Western Canada](source: Thomson Reuters)
80 western Canadian companies received VC financing in 2016, the same number as last year (Chart 8). The average number of companies attracting VC investment has remained stable, at 84, since 2006, but was substantially greater in the period 1996-2005 (average of 127).

On average, $7.6 million was invested per western Canadian company in 2016, 16 percent more than the year before and well above the historical average of $4.6 million. Deal sizes in Quebec have historically been smaller than in Western Canada, but the gap has closed considerably over the last two years. Deal sizes in Ontario are generally somewhat larger.

56 companies were from BC, making up 70 percent of the total. In Alberta, the number of companies receiving VC fell for the second year in a row, to 13—less than half as many as in 2014. In Manitoba, the number of companies rose from one to six in 2016, and in Saskatchewan, from four to five.

**Chart 8: Number of Companies Receiving VC Investment in Western Canada**

Source: Thomson Reuters
VC Investment by Company Stage of Development

We consider two stages of VC funding: “early stage” investments aimed at developing or commercializing a new product, and “late stage” investments used to expand or recapitalize a mature company. The majority of VC investment in Canada is directed towards late-stage companies, but the size of the disparity can serve as an indicator of the maturity of a particular region’s VC sector. The proportion of late-stage investment in Western Canada has increased over the last two decades (Chart 9, page 11). In the years since 2010, an average of 83 percent of VC has gone to late-stage companies; in the years before 2010, the share was 68 percent. This trend is much less pronounced in the rest of Canada; Quebec and Ontario have relatively more VC going to early-stage companies.

Early-stage investment in Alberta has slowed dramatically over the last two years: from $45 million in 2014, to $6.9 million in 2015, and only $2.4 million in 2016—making 2016 the worst year ever to be an early-stage company seeking VC investment in Alberta. The situation is even more pronounced in Manitoba and Saskatchewan. Thomson-Reuters records no VC investment in early-stage companies in Manitoba since 2009, and almost none in Saskatchewan ($4.67 million, less than four percent of the total).

The ten-year average of the share of VC going to late-stage companies can provide a more complete picture by averaging out year-to-year volatility. By this measure, Western Canada receives a slightly higher proportion of late-stage investment, 79 percent, than the rest of Canada, at 73 percent.

VC Investment by Sector

In 2016, the life sciences sector attracted 41 percent of VC investment in Western Canada, its biggest share in the last twenty years. By contrast, life sciences made up only 15 percent of investment in the rest of Canada in the same year. Life sciences includes industries like pharmaceuticals, medical devices, biotechnology, and genomics, whose large well-established markets provide lucrative opportunities to small companies selling innovative technologies. Four of the five largest Canadian VC deals in 2016 went to life sciences companies. 7

Companies in the information and communications technology (ICT) sector attracted a fairly typical 51 percent of total Western Canadian VC investment (Chart 10, page 11). Cleantech companies attracted only 1.4 percent of VC investment, down from 20 percent the previous year.

In British Columbia, the ICT sector dominated as usual, receiving 48 percent of total VC investment. Life sciences surged to $176 million, or 42 percent of investment, its largest share in over a decade. In Manitoba 59 percent of investment went to the ICT sector and 41 percent to life sciences. In Alberta, ICT received 80 percent of what little VC was invested, while life sciences were dominant in Saskatchewan.

1VC investments are assigned into one of four sectors depending on the application of the technology. These sectors are: information and communications technology (ICT); life sciences, including medical and health-care; clean technology (cleantech); and the “traditional” sector that includes retail products and business services.

Most Canadian VC funding originates within Canada, but the US is a close second. American VC funds are more concentrated in Western Canada than in the rest of Canada (Chart 11, page 11), with British Columbia and Alberta generally above the Canadian average. The volatile nature of investment in Saskatchewan and Manitoba is demonstrated here. In 2016, 22 percent of Western Canadian VC originated in the US, a little under the 20-year average of 30 percent. In Canada as a whole, 28 percent of VC funding originated in the US in 2016, in line with the 29 percent average over the last 20 years. American investment in Alberta fell to only $1.5 million, the lowest level in at least 20 years.

While Americans conduct fewer VC deals in Canada than Canadians, the deals they do make tend to be much larger (Chart 12 page 11). This is true for Western Canada and for Canada as a whole. For all of Canada, over the last 20 years, the average equity per deal was more than three times greater for deals using American funds compared with those using Canadian funds.
TYPES OF VC FUNDS

A wide variety of financial entities, from pension funds to universities, engage in VC funding. Three of the most policy-relevant categories of VC investor are:

• Independent private partnerships (IPPs) are the largest source of VC funding in most years and jurisdictions.

• Retail funds, also known as labour-sponsored investment funds, are mutual funds registered with provincial securities commissions and marketed to ordinary investors, and were a significant part of the VC market in the 2000s. Since investors in these funds receive tax credits—15 percent from the federal government, plus extra 15 percent from most provincial governments—retail funds are implicitly publicly subsidized.

• Government (public) funds sometimes engage directly in VC funding, usually through special-purpose vehicles with a specific policy goal such as the development of a particular sector. The Business Development Bank of Canada is a Crown Corporation which conducts strategic VC investments across Canada; British Columbia’s Renaissance Capital Fund fills a similar role on a provincial level. In most years and jurisdictions, such public funding is a small portion of the overall total. Public “funds-of-funds” which invest taxpayer money in private VC firms would not be counted by this definition.

In Western Canada, IPPs contributed 41 percent of VC equity over the last 20 years, while retail funds accounted for 11 percent and public funds contributed 7 percent (Chart 13). The rest of Canada shows a similar distribution. In Alberta, which has never provided a tax credit for investments in retail funds, their share of the market has been even lower: 5 percent over the last 20 years, and 0 percent since 2010. In Quebec, retail funds play a larger role, accounting for 14 percent of VC equity over the last 20 years, declining to 8 percent in the years after 2010.

Retail funds have been especially important in Saskatchewan’s VC market, where they contributed 24 percent of total VC equity over the last 20 years, actually outstripping the contribution of IPPs (21 percent). Saskatchewan provides a larger tax credit (20 percent) towards investments in retail funds than most provinces.

CHART 13: VC INVESTMENT IN WESTERN CANADA BY FUND TYPE ($M)

Source: Thomson Reuters
The federal government has introduced a number of initiatives designed to stimulate the VC market and increase investment activity in innovation. The C.D. Howe institute identified three main rationales for government involvement in VC: to improve access to capital for SMEs, to capture returns from public investments in research and development, and to support the value-added aspects of VC.\(^8\)

One such government program is the Venture Capital Action Plan (VCAP), announced in the 2012 federal budget, which invested $400 million in Canadian VC funds. There is no comprehensive public information on the companies in which these funds were invested, but some were located in Western Canada. A 2016 report by the Auditor-General found that VCAP met its short-term goals, but lacked the performance indicators needed to assess its progress in fostering Canadian innovation and strengthening the economy.\(^9\)

The Auditor-General’s report also criticized the process used to select fund managers as lacking fairness, openness and transparency.

Another example is the tax credits for retail funds mentioned above. This program, which began in the early 1980s, was heavily criticized by economists, who argued that people largely invested in retail funds for the tax benefits rather than for their returns.\(^10\) Consequently, retail funds may have attracted more money than could be wisely invested, and may not have faced incentives to maximize their returns.\(^11\)

Some have also suggested that the funds crowded out private investment and provided less value-added (such as advice and mentoring) to investment recipients.\(^12\) Retail funds consistently returned less than the market average, and recipients of retail fund investments consistently underperformed recipients of other VC funds in a variety of metrics; both findings suggest that retail funds were misallocating capital to some degree.\(^13\) Despite its flaws, the program succeeded in improving access to capital for Canadian small- and medium-sized enterprises (SMEs).

Ontario announced the end of its tax credit for retail funds in 2005, and the federal government followed suit in 2013. British Columbia and Manitoba both provide tax credits, but only to specific retail funds. Retail funds have declined significantly in importance in recent years—they accounted for only 5 percent of Canadian VC equity in the years 2010-2015 (4 percent in Western Canada, 3 percent in Ontario and 8 percent in Quebec), compared to 15 percent in the previous decade (14 percent in Western Canada, 13 percent in Ontario and 17 percent in Quebec). In Budget 2016, the Government of Canada has proposed to restore the federal tax credit, which could lead to a revival of retail funds.

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\(^8\) C.D. Howe Institute, Commentary No. 466. “Government Intervention in Venture Capital in Canada: Toward Greater Transparency and Accountability.”

\(^9\) Tabled in Parliament on May 3 2016 as one of the 2016 Spring Reports of the Auditor-General.


\(^11\) Ibid.


Western Economic Diversification Canada (WD) conducts many activities in support of start-ups, SMEs and innovation in the Western Canadian economy. Most of these activities support the VC investment ecosystem, directly or indirectly.

**The Western Innovation Initiative (WINN)** is a $100 million five-year federal initiative that offers repayable contributions for small and medium-sized enterprises with operations in Western Canada to move their new and innovative technologies from the later stages of research and development to the marketplace. Many recipients of WINN funding have also received VC investment, so WINN indirectly supports VC in Western Canada. WINN approved funding information for intake three can be found on the following page.

**Project Highlights**

**The Alacrity Foundation** was awarded $900,000 of funding under WDP towards a pilot project assisting Western Canadian SMEs to obtain American late-stage VC funding. The foundation selects companies from the ICT, cleantech and life sciences sectors and provides them with advice until they are investor-ready. Then, the foundation matches companies with American VCs and supports them through the early phases of the relationship. As of February 2016, this project has assisted 17 Western Canadian SMEs to obtain over $191 million of funding.

**The CapitalRoad Foundation** was awarded $225,000 of funding under WDP to support the Banff Venture Forum and the Canadian Financing Forum, annual events that bring innovative technology companies in the ICT and cleantech sectors together with prospective investors. Four of these events have been held so far, attended by delegates from at least 76 SMEs, as well as by WD itself.

The Western Diversification Program (WDP) provides non-repayable contributions to projects undertaken by non-profit organizations in support of WD’s strategic priorities of innovation, skills development and training, trade and investment, defence procurement, and economic opportunities for Aboriginal peoples. Several strategic priorities identify the support of SMEs as a key objective, so WDP activities indirectly support VC in Western Canada. Some WDP-funded projects which specifically aimed to foster VC markets have been described below. WDP approved funding information for its first two intakes can be found on the following page.
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<th>WINN Intake Three</th>
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<td>21 projects</td>
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<td>$22M approved funding</td>
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<td>31% of total funding allocation</td>
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<td>$10M approved funding</td>
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<td>13% of total funding allocation</td>
<td>33% of total funding allocation</td>
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<tr>
<td>$31M approved funding</td>
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<td>43% of total funding allocation</td>
<td>19% of total funding allocation</td>
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**WESTERN ECONOMIC DIVERSIFICATION CANADA**
ANNEXES
**Annex A: In-depth Summary Statistics for VC Investment**

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<tr>
<td>Arithmetic mean of total VC investment, 1996-2016</td>
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**Annex B: Histograms for VC Investment in each Western Canadian Province**

![Histograms](image)
ANNEX C: HISTOGRAMS FOR VC INVESTMENT IN CANADA AND WESTERN CANADA

HISTOGRAM OF VC INVESTMENT IN CANADA

HISTOGRAM OF VC INVESTMENT IN WESTERN CANADA